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In the Supreme Court of the United States

OCTOBER TERM, 1945

No. 436

M. M. ARGO, PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE FIFTH CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

OPINIONS BELOW

The opinion of The Tax Court of the United States (R. 68–91) is reported in 3 T. C. 1120. The opinion of the Circuit Court of Appeals (R. 162–165) is reported in 150 F. (2d) 67.

JURISDICTION

The judgment of the Circuit Court of Appeals was entered on June 20, 1945. (R. 165.) The petition for a writ of certiorari was filed on September 18, 1945. The jurisdiction of this Court

is invoked under Section 240 (a) of the Judicial Code, as amended.

QUESTIONS PRESENTED

1. Whether the Commissioner is precluded from attacking the recognition of a family partnership for tax purposes for the years 1938, 1939 and 1940 by reason of the judgment of the District Court in favor of taxpayer and against the Collector for the recovery of income taxes for the year 1937.

2. Whether there is any warrant in the record for the Tax Court's conclusion that a family partnership arrangement involving the taxpayer, his wife, and three children should not be recognized for tax purposes and hence that the income from the business for the years 1938, 1939 and 1940 remained taxable to the taxpayer under Section 22 (a) of the Revenue Act of 1938 and of the Internal Revenue Code.

STATUTES INVOLVED

Revenue Act of 1938, c. 289, 52 Stat. 447:

> SEC. 22. GROSS INCOME.
>
> (a) *General Definition.*—"Gross income" includes gains, profits, and income derived from salaries, wages, or compensation for personal service, of whatever kind and in whatever form paid, or from professions, vocations, trades, businesses, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such

property; also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever. * * *

* * * * *

SEC. 181. PARTNERSHIP NOT TAXABLE.

Individuals carrying on business in partnership shall be liable for income tax only in their individual capacity.

The corresponding provisions of the Internal Revenue Code are identical.

Internal Revenue Code:

SEC. 3772. [as amended by the Revenue Act of 1942, c. 619, 56 Stat. 798, Sec. 503]. SUITS FOR REFUNDS.

* * * * *

(d) *Suits Against Collector a Bar.*—A suit against a collector (or former collector) or his personal representative for the recovery of any internal revenue tax alleged to have been erroneously or illegally assessed or collected, or of any penalty claimed to have been collected without authority, or of any sum alleged to have been excessive or in any manner wrongfully collected shall be treated as if the United States had been a party to such suit in applying the doctrine of res judicata in all suits instituted after June 15, 1942, in respect of any internal revenue tax, and in all proceedings in the Board and on review of decisions of the Board where the peti-

tion to the Board was filed after such date. (26 U. S. C., Sec. 3772.)

STATEMENT

The facts as found by the Tax Court may be summarized as follows (R. 70–83):

During 1936 taxpayer owned all the capital stock of the Birmingham Electric & Manufacturing Company, a corporation organized under the laws of Alabama, and engaged in the business of repairing and rebuilding electrical machinery and equipment. The business, both while operated as a corporation and as an unincorporated concern, was of a type requiring technical knowledge. Taxpayer is a graduate electrical engineer and he has been engaged in that profession since 1912. He was president of the corporation and received a salary for the year 1936 of $12,000. (R. 70.)

During 1936 taxpayer discussed with an attorney, an auditor, and a certified public accountant the question of dissolving the corporation and forming a partnership consisting of himself, his wife, and his three minor children. The possibility of a saving in income taxes was also discussed. Taxpayer's attorney advised him to form the partnership and stated it could be accomplished legally without the execution of a written agreement. The proposed partnership was also discussed by taxpayer during the latter part of 1936 with his wife, Esther B. Argo, and his chil-

dren, Malcolm M. Argo, Jr., then of the age of 18, Ann A., then of the age of 16, and Sarah Ellen, then of the age of 7. Malcolm M. Argo, Jr., became of age on July 9, 1939, and Ann A. Argo in January, 1941. As a final result of these discussions taxpayer told his wife and children that he was going to dissolve the corporation and was going to make an outright gift to each of them of a one-fifth interest in the partnership and that they would be partners with him and be responsible for any debts of the partnership. It was understood that taxpayer was to receive $6,000 a year from the profits and would manage the business, with the right to operate it as he saw fit. The profits after deducting the taxpayer's $6,000 per annum were to be distributed equally among the other four members of the family. (R. 70–71.)

At that time taxpayer's wife owned no property except the family home, which was encumbered by a mortgage on which taxpayer was liable. Her occupation was that of a housewife, and she was without any income other than a small amount derived from writing. The occupation of the children was that of attending school and they had no property or income. (R. 71.)

During the time that the business was operated as a corporation taxpayer's wife frequently helped with the office work, his son worked for the business during his school vacations, and his oldest

daughter also worked for the business during her school vacations. (R. 71.)

On December 31, 1936, the Birmingham Electric & Manufacturing Company, the corporation, was dissolved, and taxpayer, as its sole stockholder, received all its assets and assumed its liabilities. These assets were immediately credited to an unincorporated business which thereafter conducted the same character of business as had the corporation and under the same name as that of the corporation. This unincorporated business will be sometimes referred to hereinafter as the company. (R. 71–72.)

Taxpayer instructed his bookkeeper to make entries on the company's books dividing interests in the company equally among the five members of the family, and he told her that he was making a gift to his wife and children of those interests. She was also told that taxpayer was to receive $6,000 annually from the profits and the remaining profits were to be distributed equally among the other four members of the family. In January, 1937, capital accounts were opened on the books crediting each member of the family with a total of $4,317.58. (R. 72.)

Taxpayer did not execute any deed, bill of sale, or other written form of conveyance transferring any interest in the business to his wife or children. After January 1937 the every-day operations of the company continued in the same

manner and under the same name as during incorporation, except for capital accounts, and for accounts of withdrawals by each of the members of the family in the case of the company. Taxpayer continued to handle and control the affairs of the company as he had in the case of the corporation. (R. 72.)

During the taxable years taxpayer's wife assisted in the business of the company when it was convenient for her to do so at night, as she was attending to her household affairs during the day, or on Saturday afternoon. She did clerical work, filing, and typing letters. She received no salary. (R. 74.)

Taxpayer's son Malcolm, Jr., attended college throughout 1937, except for the summer vacation period, during most of which period he assisted in the business of the company during afternoons in the shop and on night emergency calls when pumps or motors in coal mines were damaged by electrical storms. He also assisted his father during that year in managing the business. During the first half of 1938 he was away at college and during the remainder of the year, except while on a vacation in Cuba, he attended a local college during the morning and worked in the company warehouse in the afternoon, repairing and reconditioning motors. He attended college throughout 1939 and until graduating as an electrical engineer in June, 1940, when he began

working for the company on a full time basis, continuing to do so until he enlisted in the Army in October, 1940. He received no salary. (R. 74.)

Taxpayer's daughter Ann was away at college during 1937, except for a summer vacation, during half of which she attended a local college in the mornings. In the afternoons when not in school she helped in the business with filing and stenographic work. She did no work in 1938, being away at school during both the regular and summer terms. She did no work in 1939. In 1940 she did no work until October, after graduation. The balance of that year she worked regularly in the office or in the plant, operating machines and helping make carbon brushes. She received no salary. Taxpayer's daughter, Sarah Ellen, did no work for the company at any time. (R. 74.)

For the years 1937, 1938, 1939 and 1940 the company books in the various capital accounts of taxpayer, his wife and his three children, the partnership returns of income filed by taxpayer, and the individual income tax returns filed by the members of the family show net distributable profits as follows (R. 76, 78):[1]

[1] In the printed record, several tables have been shifted. For example, the table shown here appears in the printed record under the designation of drawing accounts (R. 78); whereas, in the original record it appears under the designation of distributable profits. Again, the first table designated as checks drawn to the order of the taxpayer in reality represents the drawing accounts. (R. 78.)

	1937	1938	1939	1940
M. M. Argo	$6,000.00	$6,000.00	$6,000.00	$6,000.00
Esther B. Argo	2,496.72	1,988.47	1,164.21	826.47
Malcolm M. Argo, Jr	2,496.72	1,988.48	1,164.21	826.47
Ann A. Argo	2,496.72	1,988.48	1,164.21	826.47
Sarah Ellen Argo	2,496.72	1,988.48	1,164.20	826.47
	15,986.88	13,953.91	10,656.83	9,305.88

The above listed profits of $10,656.83 in 1939 include $4,600 in personal commissions now conceded by taxpayer to be his individual income, taxable to him as such. (R. 78.)

There were no drawing accounts on the books for taxpayer's wife and children during 1937. All withdrawals by or for them during that year, totaling $7,650, were charged to taxpayer on the books. Neither taxpayer's wife nor his children had authority at any time to draw checks on the company's bank account. (R. 78.)

Drawing accounts on the books of the company reflect withdrawals for the years 1938, 1939 and 1940 as follows (R. 78):

	1938	1939	1940
M. M. Argo	$6,000.22	$4,934.39	$2,481.55
Esther B. Argo	1,240.10	1,364.66	2,983.67
Malcolm M. Argo, Jr	1,117.33	1,432.62	1,324.20
Ann A. Argo	688.97	1,551.12	1,219.17
Sarah Ellen Argo	65.10	1,155.62	1,243.67
	9,111.72	10,438.41	9,252.26

The withdrawals totaling $10,438.41 for 1939 include erroneous charges for withdrawals not in fact made, in the amount of $4,600, charged to

the extent of $600 against taxpayer's account and $1,000 against each of the remaining accounts. (R. 78.) The foregoing drawing accounts of taxpayer's wife and children, and the amount of withdrawals listed as above therein, also include a number of items based on checks drawn to the order of taxpayer and deposited in his individual bank account as follows (R. 79):

	1938		1939		1940	
	Number of checks	Amount	Number of checks	Amount	Number of checks	Amount
Esther B. Argo	2	$300.00				
Malcolm M. Argo, Jr.	6	750.00	2	$125.00		
Ann A. Argo					2	$247.40
Sarah Ellen Argo					1	625.00
	8	1,050.00	2	125.00	3	872.40

Taxpayer's wife had an allowance for running the house and would obtain what money she needed from the bookkeeper for household and personal expenses. Her withdrawals represented these amounts, except those represented by the checks deposited as above shown to taxpayer's individual bank account. (R. 79.)

There were no "dollars and cents" restrictions on Malcolm Jr.'s withdrawals. When he needed money he would ask the bookkeeper for it and she would let him have it. Ann made her withdrawals by asking her father or the office for them. She did not have to consult her father, but she was not allowed to make promiscuous withdrawals in large amounts. The moneys re-

ceived by each of the children through their withdrawals were used for school allowances, clothing, doctors and hospital bills, and for the other needs of each, except for those withdrawals represented by checks deposited in the taxpayer's individual bank account as above shown. (R. 79.)

The 1936 income and excess profits tax return of the corporation, Birmingham Electric & Manufacturing Company, was subscribed and sworn to by taxpayer as president on March 12, 1937, and filed with the Collector of Internal Revenue for the District of Alabama on March 15, 1937. (R. 79.) On a schedule attached thereto appears the following statement (R. 80):

COMMENT RELATIVE TO DISSOLUTION

> This corporation was dissolved on December 31, 1936, and the net assets were distributed to the stockholder in complete liquidation and cancellation of the capital stock as of that date. The business will be conducted henceforth without interruption by M. M. Argo, as a proprietorship.

Under date of February 23, 1937, taxpayer addressed the following letter to the "Secretary of Treasury, Att: Commissioner of Internal Revenue" (R. 80):

> As provided in Article 308 of Regulation 90 relating to excise tax on employers under Title 9 of Social Security Act, I am hereby giving notice that the Corporation

known as Birmingham Electric & Mfg. Company was dissolved December 31, 1936 and that henceforth the business will be conducted under the same name by M. M. Argo as proprietor.

Annual returns of excise tax under Title IX of the Social Security Act for the years 1937 and 1938 were filed with the same Collector on behalf of the company by taxpayer, who executed the affidavit thereto as "M. M. Argo, Owner." (R. 80.)

Employer's summary information returns under Title VIII of the Social Security Act for the periods January 1 through June 30, 1937, and July 1 through December 31, 1937, were filed with the same Collector on behalf of the company by taxpayer, who executed the affidavit thereto as "M. M. Argo, Owner." (R. 80.)

Seven employer's tax returns under the same title and act were filed with the same Collector quarterly on behalf of the company for the period ended March 31, 1938, through the period ended September 30, 1939, by taxpayer, who executed the affidavit to each as "M. M. Argo, Owner." (R. 80–81.)

Taxpayer filed personal property tax list returns with the tax assessor of Jefferson County, Alabama, covering the personal property of the company, and executed affidavits thereto on December 8, 1937, and October 6, 1938, respectively,

wherein he stated that he was the "owner" of such property. (R. 81.)

Taxpayer, on or about June 10, 1937, filed a financial statement and balance sheet of the company with the First National Bank of Birmingham for credit purposes. The heading, "Corporation," on the printed form was stricken out and the word, "Individual," substituted. The statement showed "condition at close of business April 30th, 1937." The statement was signed in the name of the company, "By M. M. Argo Title of Officer, Owner." On or about March 24, 1939, a balance sheet of the business as of February 28, 1939, was filed by taxpayer with the same bank. It was signed, "M. M. Argo, Owner." (R. 81.)

On December 16, 1940, taxpayer filed a complaint against Henry J. Willingham, the Collector of Internal Revenue for the District of Alabama, in the District Court of the United States for the Southern Division of the Northern District of Alabama, for the recovery of income taxes for the year 1937 alleged to have been paid April 19, 1940, in the amount of $876.14, plus interest, in response to a notice of deficiency determined on the ground that, "there was no bona fide partnership (referring to the Birmingham Electric & Manufacturing Company) and that the net income reported on form 1065 actually represented net income to Mr. M. M. Argo from his individually

conducted business under the name of Birmingham Electric & Manufacturing Company." The complaint further alleged that the business was a partnership during 1937 and that the Commissioner erred in taxing petitioner with all the income of the business. A general denial to this complaint was filed. (R. 81.)

On February 24, 1941, the District Court entered an "Order on Pre-Trial Hearing" wherein it was stated that (R. 82):

> It was agreed by all of the parties that the following are all of the issues in controversy in this cause:
>
> Plaintiff claims refund of income taxes for the year 1937, under the revenue laws of the United States because The Birmingham Electric and Manufacturing Company was a partnership throughout the entire calendar year 1937 and the plaintiff was taxable only on partnership income accruing to him.
>
> Defendant pleads:
>
> (1) The general issue; and
>
> (2) In the taxable year, plaintiff was the individual owner of the said business and was taxable on the entire income therefrom and there was no partnership.

On October 16, 1942, an order of the Court was entered as follows (R. 82–83):

> This cause coming on to be heard prior to the submission of the cause to the jury, the parties stipulated by their respective

counsel, in open Court, that if the jury found from the evidence that there was a partnership between the plaintiff and his wife, and three children during the calendar year 1937 that judgment should be rendered upon such verdict in favor of the plaintiff for the sum of $985.31, plus interest thereon at six per cent per annum from and after April 19, 1940, until paid as provided by law, and that on the other hand, if the jury found from the evidence that no such partnership existed during the calendar year 1937, then judgment should be rendered upon such verdict in favor of the defendant, and the case thereupon being submitted to the jury, the jury reported a verdict as follows:

"We, the jury, find that there was a partnership during the year 1937.

"C. L. COLLINS,
"Foreman."

it is accordingly by the Court

Ordered, Adjudged, and Decreed that the plaintiff herein have and recover of and from the defendant herein the sum of Nine Hundred Eighty-five and 31/100 ($985.31) Dollars, * * *

An appeal from this judgment of the District Court was taken by Henry J. Willingham, Collector, defendant in the suit, to the United States Circuit Court of Appeals for the Fifth Circuit, and on motion filed by the appellant the appeal was dismissed. (R. 83.)

The taxpayer's petition before the Tax Court covering the years 1938 and 1939, was filed February 21, 1942. The petition covering the year 1940 was filed on August 24, 1942. (R. 83.) Before the Tax Court the taxpayer pleaded the judgment against the Collector as *res judicata.* (R. 83.)

The Tax Court held that the judgment of the District Court against the Collector was not *res judicata* in the present proceeding against the Commissioner, and that the partnership was not required to be recognized for tax purposes for the years 1938, 1939, and 1940. (R. 88, 90.) The court below affirmed the decision of the Tax Court. (R. 162–165.)

ARGUMENT

1. The decision below is plainly correct under well established principles of tax law. As taxpayer concedes (Br. 32–33), the judgment of the District Court in favor of taxpayer and against the *Collector* for the recovery of income taxes for 1937 is not *res judicata* in the proceeding against the *Commissioner* wherein the latter refused to recognize the partnership for tax purposes for 1938 and 1939. *Bankers Coal Co.* v. *Burnet,* 287 U. S. 308; *United States* v. *Nunnally Investment Co.,* 316 U. S. 258.[2]

[2] Section 3772 (d) of the Internal Revenue Code, *supra,* which is a legislative reversal of the doctrine that a judgment in a suit against the Collector is not *res judicata* in a subsequent suit against the Commissioner or the United

Hence the Tax Court was free to make its independent finding from all the evidence, with the judgment of the District Court clearly entitled to no "greater weight" than the other evidence contained in the record. (Cf. Pet. Br. 32–34.) See *Sage* v. *United States*, 250 U. S. 33; *Bankers Coal Co.* v. *Burnet*, *supra*; *United States* v. *Nunnally Investment Co.*, *supra*; cf. *Webre Steib Co.* v. *Commissioner*, 324 U. S. 164.

Moreover, there is no necessity for review by this Court of the holding by the courts below as to the inapplicability of the doctrine of *res judicata* to the tax year 1940 since there is unanimity of opinion among the Circuit Courts of Appeal that the doctrine does not apply to the type of problem involved herein where events which determine tax liability are not identical from year to year.[8] Thus, if the

States, does not apply since the petition for redetermination of the deficiencies for 1938 and 1939 was filed before June 15, 1942, its effective date. (R. 83.) However, the section does apply to the controversy for 1940, since the petition for redetermination for that year was filed after June 15, 1942. (R. 83.)

[8] As distinguished from the situation where the question in issue is identical with that decided in the earlier case although involving a different tax year, and arises out of the same facts and historical events which appeared in the record of the former decision. For example, the doctrine of *res judicata* has been held to apply where the questions were whether the bond discount amortized was on the taxpayer's own bonds (*Tait* v. *Western Md. Ry. Co.*, 289 U. S. 620), whether the taxpayer or his children were the owners of certain shares of the family corporation on which the dividends were issued (*Montgomery* v. *Thomas*, 146 F. (2d) 76

question is whether the taxpayer is doing business during the taxable year (*Stoddard* v. *Commissioner,* 141 F. (2d) 76 (C. C. A. 2d)), is selling its product to a subsidiary in an arm's-length transaction (*Campana Corp.* v. *Harrison,* 135 F. (2d) 334 (C. C. A. 7th)), is a social or business club; *Engineers' Club of Philadelphia* v. *United States,* 42 F. Supp. 182 (C. Cls.), Certiorari denied, 316 U. S. 700), or is a manufacturer (*Henricksen* v. *Seward,* 135 F. (2d) 986 (C. C. A. 9th); *Monteith Bros. Co.* v. *United States,* 142 F. (2d) 139 (C. C. A. 7th)), since each year involves similar but not identical factual patterns, the answer must be given in light of the facts of the current year and not by reference to the preceding judgment. Hence where, as here, the problem is not solely the construction of a written or perhaps oral partnership agreement, the conclusion that a partnership exists for tax purposes must depend in each year upon an appraisal of the actual activities and interrelations of the alleged partners and the doctrine of *res judicata* cannot apply.

The case of *Leininger* v. *Commissioner,* 86 F. (2d) 791 (C. C. A. 6th), advanced by taxpayer (Br. 18), is not in conflict with the instant case. There, although the judgment of this Court in

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(C. C. A. 5th)), or whether the taxpayer was a transferee (*Commissioner* v. *Western Union Tel. Co.*, 141 F. (2d) 774 (C. C. A. 2d)). But see *Pelham Hall Co.* v. *Hassett*, 147 F. (2d) 63 (C. C. A. 1st); *Commissioner* v. *Netcher*, 143 F. (2d) 484 (C. C. A. 7th), certiorari denied, 323 U. S. 759.

Burnet v. *Leininger,* 285 U. S. 136, was held to be *res judicata* as to the husband and wife partnership for later years, the court was careful to say that the new facts sought to be introduced occurred before and affected the husband's status for the tax years in the case decided by this Court and that the husband had no competent evidence to indicate any change in his status for the subsequent tax years. Contrary to taxpayer's assertion (Br. 31), the Commissioner did contend in the court below that (Government's brief, p. 21) there were differences in 1937 and 1940 with respect to the operation of the so-called partnership and the activities and interrelations of taxpayer and his family. In any event, since the issue here involved is not the existence of the partnership in 1937 but in 1940, the court below was correct in holding that in order to work an estoppel by judgment, taxpayer had to show, but did not, that the facts upon which the earlier judgment was based were identical with those arising in 1940. *Russell* v. *Place,* 94 U. S. 606; *Leicht* v. *Commissioner,* 137 F. (2d) 433 (C. C. A. 8th).

2. The decision below presents no occasion for this Court to define further the application of the "substantial evidence" rule to review of decisions of the Tax Court (cf. Pet. Br. 34–37). *Dobson* v. *Commissioner,* 320 U. S. 489, rehearing denied, 321 U. S. 231. For, the court below correctly affirmed the judgment of the Tax Court, either

upon the ground that the facts amply supported the judgment, or upon the ground that income is legally attributable for tax purposes to the person who earned it or whose property produced it. *Helvering* v. *Horst,* 311 U. S. 112; *Helvering* v. *Eubank,* 311 U. S. 122; *Lucas* v. *Earl,* 281 U. S. 111; *Harrison* v. *Schaffner,* 312 U. S. 579; cf. *Griffiths* v. *Commissioner,* 308 U. S. 355; *Commissioner* v. *Court Holding Co.,* 324 U. S. 331. With evidence that taxpayer alone supplied the technical knowledge necessary for the conduct of the business and that the profits during the tax years in question were wholly disproportionate to the capital utilized and invested in the business, the Tax Court surely could not properly be charged with error in finding, or the Circuit Court of Appeals in affirming, that taxpayer was taxable as the real earner of the income. *Lucas* v. *Earl, supra.*

Although this Court is to consider the problem of the family partnership as a device for tax avoidance (see *Commissioner* v. *Tower,* No. 317, this Term, certiorari granted, October 8, 1945, and *Lusthaus* v. *Commissioner,* No. 263, this Term, certiorari granted October 8, 1945), we think the instant case presents merely a familiar instance of an effort to make an anticipatory assignment of income ineffective to relieve the real earner from tax thereon and does not reveal any additional phase of the family partnership problem which should be before this

Court. There is no more reason for further review in this case than in *Doll* v. *Commissioner,* No. 138, this Term, where the Court denied certiorari on the same day that it granted the petitions for certiorari in the *Tower* and *Lusthaus* cases.

CONCLUSION

The decision below is correct; there is no occasion for further review of the issues involved. The petition should therefore be denied.

Respectfully submitted.

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OCTOBER 1945.

U. S. GOVERNMENT PRINTING OFFICE: 1945